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C O N F I D E N T I A L SECTION 01 OF 03 LAGOS 001341

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STATE PASS TREASURY FOR ASEVERENS AND SRENENDER
STATE PASS DOC FOR PHUPER
STATE PASS TRANSPORTATION FOR MARAD
STATE PASS OPIC FOR ZHAN AND MSTUCKART
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STATE PASS EXIM FOR JRICHTER
STATE PASS USTR FOR ASST USTR SLISER
STATE PASS USAID FOR GWEYNAND AND SLAWAETZ

E.O. 12958: DECL: 08/22/2015
TAGS: ECON EPET NI
SUBJECT: NNPC ATTEMPTS TO FORCE MAJORS TO SELL, REFINE
CRUDE IN-COUNTRY AT CONTROLLED PRICES

Classified By: Consul General Brian L. Browne for Reasons 1.4 (D & E)

Summary

¶1. (C) U.S. major oil firms are concerned about new Nigerian National Petroleum Corporation (NNPC) proposals to mandate in-country refining. In a series of meetings with ExxonMobil, Chevron, and ConocoPhillips, as well as with Shell, top executives raised alarm over a recently proposed regulation mandating in-country refining. If passed as is, executives report the actions could significantly reduce investment in the Nigerian petroleum sector. NNPC held hearings on the proposal on 24 August. Right now, we don't know whether the GON is serious about enacting these regulations or whether it is being used to leverage other, less ambitious concessions from the majors. Mission will report industry read-out on hearings septel. Additionally, at the request of industry, Mission is attempting to arrange a meeting between Ambassador Campbell and Minister of State for Petroleum Daukoru to raise these important concerns.

Proposal for Mandatory Domestic
Refining Takes Industry by Surprise

¶2. (C) In an August 5 letter to major oil companies operating in Nigeria, NNPC Group Managing Director Funsho Kupolokun forwarded a proposal for mandatory in-country refining of oil for those companies producing over 50,000 barrels per day of crude. The proposal would require the majors to meet 80 percent of the country,s domestic refining capacity by 2006, and 90 percent of its capacity by 2007. NNPC said it would hold hearings on the proposal on 24 August. While we do not know his position on the specific regulation at hand, President Obasanjo previously has expressed his belief, in principle, that oil majors should contribute to Nigeria's refining capacity. We have seen similar measures proposed in the National Assembly. However, this proposal may be a more imminent threat because, as an NNPC regulation, it does not need to go through the slow moving legislative process. As a regulation, this proposal could be enacted very quickly, simply by the Executive or NNPC, with little right to public comment or review.

Majors Universally Opposed to Proposal;
Requests USG Assistance

¶3. (C) In a series of separate discussions, ExxonMobil Nigeria Managing Director (MD) John Chaplin, Chevron Nigeria General Manager for Asset Management Chuck Taylor and Public and Government Affairs General Manager Femi Odumabo, ConocoPhillips Managing Director Todd Creeger, and Shell Petroleum Development Corporation MD Basil Omiyi, universally expressed alarm at the recent proposal. In an August 19 meeting, Chaplin indicated the industry was worried. He stated &this is very serious,8 if the proposal were approved, &we would stop investing in Nigeria.8 As the Chairman of the Lagos Chamber of Commerce Oil Producers, Trade Sections (OPTS), the industry's advocacy group, he indicated the industry was drafting a common response to the proposal. He also requested intervention from the USG to assist, specifically noting a meeting between Ambassador Campbell and Minister of State for Petroleum Daukoru would be helpful.

OPTS Views Proposal as Expropriatory
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¶4. (C) Chaplin indicated OPTS opposed the proposal on constitutional, statutory, and contractual grounds. OPTS considers the proposed regulation as expropriatory. By demanding in-country refining, the regulators would effectively seize and control a portion of the crude oil to which the majors are legally entitled under their Memorandums of Understanding and Joint Venture Agreements. The majors note NNPC, as the dominant equity partner in the joint venture (JV) area, already owns 60 percent of the crude produced under most JV arrangements with the majors entitled to only 40 percent. They believe NNPC and the Nigerian Government should first look to their own crude to meet the government's in-country refining targets. Chaplin stated the NNPC already possessed far more crude than domestic refineries could handle. However, he noted President Obasanjo (and Minister of Petroleum Resources) &sees this as a social obligation8 on the part of the majors.

Proposal Appears to Force Crude Sales at Controlled Prices
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¶5. (C) The downstream sector in Nigeria remains price-controlled, and Chaplin said NNPC had indicated majors would not receive the world market price for domestically refined product under this new proposal. (Note: In large measure, due to price regulation, Nigeria,s refining sector is moribund, with its four parastatal refineries operating well below capacity.) Additionally, the proposal sets fees for domestic refining, termed an &incentive8 fee. Majors note that a set refining fee, with no competition, simply forces them to subsidize an uneconomic and wasteful refining industry, and would delay any meaningful reform in the Nigerian refining sector.

Chilling Impact on Future Investment

¶6. (C) Chaplin, Taylor, and Creeger all claim the proposal would chill the investment climate in the petroleum sector. By acting as an additional tax on the sector, it would stall additional investment necessary to grow oil production in Nigeria, undermining the GON,s goals of doubling oil production by 2010. For firms such as Conoco Phillips, which currently produces less than 50,000 bpd (and hence would not be subject to the mandate as currently constructed), it would put the brakes on additional production which would take them over the threshold.

Industry Decries Investment Climate in Sector

¶7. (C) Chevron,s Chuck Taylor noted the proposal was typical of the type of proposals the sector has seen recently from the GON, stating he was &horribly concerned with the overall trend in the last 12-18 months.8 Echoing comments from other industry figures, he pointed out &the industry operates here with profit margins which are the smallest or among the smallest in the world. There is not a lot of room before investment will be impacted."

Comment

¶8. (C) In addition to the potentially negative consequences of the proposed regulation, NPPC's attempt to make such an existential change via administrative regulation and not through the legislative process is troubling. While we have yet to determine if the GON is completely earnest about this regulation or whether it is a cat's paw to induce other less fundamental concessions from the companies, we are concerned that such a proposal has even been put on the table. This type of suprise is becoming frequent in Nigeria. A bad strain of economic populism or nationalism seems to be advising the GON's approach to the oil majors. The GON appears to be giving contract sanctity and creation of a favorable investment climate short shrift. Many in the industry believe President Obsanjo is behind this latest move. We are not sure of that assertion. However, President Obasanjo is stuck between a moribund refining sector, demands by the Nigerian citizens for affordable crude products, and international crude prices which show no signs of falling. We do know President Obsanjo expects the majors to play a greater role in helping him resolve these conflicting problems than they believe is within their ambit or their margin of profit. Finding a sustainable balance will be tough and will likely need the help of some will-timed advocacy efforts on our part.

¶9. This cable was cleared by Embassy Abuja.
BROWNE